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Agricultural Situation

CAP Reform in the UK – implementation and effect

2005

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Report Highlights:
England, Wales, Scotland and Northern Ireland began implementation of the EU 2003 CAP reforms in January of 2005, the earliest possible date. This report tracks the initial stages of reform, with particular focus on the response of the English farming industry.

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Executive Summary

National legislation implementing the 2003 EU CAP reforms came into effect in the United Kingdom on January 1, 2005. Variations in the reform implementation adopted by England, Wales, Scotland and Northern Ireland (per UK4002) mean that there is a range of processes and responses within the UK. However, the general experience thus far has been of steady progress toward publicized goals with regard to the practical logistics of implementation. Indicators suggest that changes in farming practice and broader economic shifts are only slowly beginning to take place but that, in time, decoupled support for agriculture will allow the farming industry to take on the market-shape originally anticipated by Franz Fischler, architect of the European reforms.

Implementation

Implementation Timeline

Applications for the Single Farm Payment (SFP) were made available in the UK in January of 2005. The introduction of decoupled agricultural support and the transition to a flat rate SFP was widely publicized by the government and has resulted in a high level of awareness of the new system by farmers and land managers.

While each region varies in its policy, for the purposes of this report the main focus is on England. English farmers who make a valid application for the SFP in 2005 will receive entitlements per hectare. According to the Department of Environment, Food & Rural Affairs (Defra), this comprises a flat rate area-based element and, where appropriate, an historic element (the reference amount) normally based on their subsidy receipts during the reference period (2000 – 2002). Where adverse circumstances or hardship affecting the producers' ability to make claims during the reference period may have occurred, there are special provisions under which farmers' reference amounts may be adjusted.

Applications received by the June 10, 2005 deadline for submission have not yet been fully processed, but officials from Defra report the receipt of approximately 120,000 applications. If all applications are successful in securing funding, this number indicates an increase of 40,000 farmers (50 per cent) who will be receiving subsidies as compared to the pre-reform situation. Much of the increase in numbers can be attributed to applications received from non-arable crop producing land managers such as horse breeders, who were not eligible for subsidies under pre-reform legislation. However, as many of these new applicants are claiming for relatively small land parcels, there should not be a dramatic decrease in the amount of funding individual farmers receive under the new system.

The Rural Payment Agency (RPA), which administers the SFP on behalf of Defra, is steadily processing the 120,000 received SFP applications. As the level of payment is partly dependent on the total level of claims, checks cannot be sent out until all applications have been processed. According to the official timeline for the scheme, the first payment in England is scheduled to be made in February 2006. However, industry observers do not expect payment to actually commence until March or April of that year. As they have a smaller number of applications to process, the Welsh and Scottish payments are likely to be made a bit earlier, in December of 2005. Defra has indicated that interim payments are not favored policy in England; conversely, these are a real possibility in Wales and Scotland.

Difficulties Encountered

Farmers have found it difficult to navigate the paperwork for the new system. Deadlines for the SFP hardship applications had to be extended and the RPA has had to return a large proportion of incorrectly submitted SFP applications. More specifically, the provision of adequate explanation for farmers of new terms and form-codes has been a problem. The debate over the definition of 'non-agricultural use' provided by the EU Council was particularly contentious and led to involvement on the part of farming interest groups. For example, the Country Land and Business Association (CLA) met with the EU Commission in order to build up some guidance as to the activities permitted on agricultural land receiving SFP. After much debate, the UK government published official guidance as to the meaning of the term on March 29, 2005. More generally, grievances have been aired with regard to the level of bureaucratic guidance provided to applicants. For example, the CLA comments: "there is no sheet of explanation of the 43 codes so they cannot blame farmers for using the wrong codes."

While the introduction of the new system has certainly been cause for some confusion, frustrations have been minimized successfully. Although farmers initially reported difficulty in accessing assistance from the Rural Payments Agency (RPA), this underestimation of the human resources necessary for the transition to SFP was remedied through agency cooperation with the National Farmers Union (NFU). The NFU supplemented the support available to SFP applicants by means of regional meetings and the provision of a free helpline which, over the course of the SFP application period, fielded approximately twelve thousand calls. It is worth noting that those most confused by the SFP system seem to be first-time applicants - that is to say, those with no history of funding support. However as most of these applicants are claiming for small land parcels, the payments to be penalized and the accompanying levels of concern are quite small.

Although it is crucial for farmers to file this year in order to continue receiving support in the future, the extensions and built in buffer periods of the SFP system seem to be adequate mechanisms for dealing with deadline complications. For example, in England, amendments (such as claiming extra parcels of land, changing the land use codes or schemes being claimed on) could be submitted without penalty until May 31, 2005. Amendments submitted after that date and before June 10 were subject to reductions of 1 percent per day on payment for affected parcels. Late applications received between May 17 and June 10 were reduced by 4 percent per working day. Additional arrangements for delays arising from natural disaster, the correction of errors and withdrawal of all or part of the application were also made.

Enforcement and Monitoring

Under EU law, the UK must establish an inspection and enforcement system to determine compliance with CAP reform regulations. Each administration within the UK will determine its own arrangements for enforcing cross-compliance standards. Defra is working closely with the RPA and other relevant specialist agencies in order to establish an enforcement system and accompanying appeals system.

Historically, the British government has a weak record for sanctioning farmers for violations of the measures required to receive funding. No indications have been made that the UK government will be modifying their policing methods: Defra explains that they intend to "build on current good practice." This may be a strategic decision, reflecting the requests voiced by English farmers to allow them a bit of time to settle into the new regulatory system.

On July 4, 2005, the UK government announced its new Agricultural Change and Environmental Observatory Program. Over the course of 3 years and a 1 million pound budget, Defra will utilize the program to monitor impacts of 2003 CAP Reform on the English environment.

Economic and Sector Repercussions

The general expectation of the SFP system, as enunciated by Defra, is that it will allow farmers greater freedom to farm to the demands of the market as subsidies are decoupled from production. At the same time, it will allow for environmentally friendly farming practices to be better acknowledged and rewarded.

The formal response from the farming industry to CAP reform implementation in England has been positive thus far: both the CLA and NFU have publicly indicated their support for the measures thus introduced. However, six months into the reform, it is clear that actual change in the farming industry will be a gradual process.

Specifically, most pre-reform analyses suggested that the market rationalization process would allow inefficient farmers who were previously locked into production-oriented land management in order to receive subsidies to be able to increase their profits by discontinuing their farming activities in favor of diversification. At the same time, more efficient farmers would be able to continue but with greater scope for expansion or alteration to their farming systems. As decision-makers begin to farm “to the market,” sectoral shifts reflecting the geographic suitability and efficiency of various regions would likely occur, with a resulting increase in the homogeneity of production by region.

While indicators do not provide any reason to believe that the industry will not develop along these lines, the lack of change in the past six months suggests that, in fact, these changes will happen over a number of years. The NFU reports that most farmers are taking a “wait and see” approach. In keeping with this sense of measured anticipation, there has been little investment in farming industries and very low land transfer rates in the past year. Economists at the NFU do not expect the decision-making mentality and behavior of their members to change very much before 2007.

For example, in the arable sector, even though the crops planted last autumn will be harvested under the new subsidy system, there was not much evidence of large changes in planting patterns. Though the results of a recent HSBC survey suggest some changes (ie, that 51% of farms will be changing their cropping pattern in the coming year and that 40% of farms anticipate planting fewer cereal crops), much of this change may in fact be attributed to changes in price levels which were already a factor in farmers’ decision-making process prior to CAP reform implementation. UK farm consultants, Anderson’s, expect that most farmers will probably carry on with similar cropping patterns until they see the first SFP check arrive. They have similar expectations for the livestock sector.

Looking at other sectors within the farming industry reaffirms that CAP reforms are only one of many factors in farmers’ calculations. For example, though a reduction in beef production was anticipated as a result of CAP reform, the unresolved but looming changes to the over-thirty-month rule for cattle, which currently prevents all cattle over the age of thirty months from entering the food chain, is currently garnering far more attention in the sector. Similarly, as dairy farmers are eligible for subsidies for the first time as a result of CAP reforms, the new system could infuse the sector with new life. More important at the moment though are fluctuations in the price of milk and farmers’ ability to market milk as a premium product.

The unchanged production patterns of farmers in the short term may be explained by noting that, even faced with a low or negative net margin of profit, the decision to temporarily cease production does not ensure a profit: while stopping production reduces some direct (cropping and labor) costs, the cost of property and other overheads remain while general income from crop sales disappears. Moreover, on the whole, balance sheets across the farming industry are strong enough that producers are not in the position of being forced into decisions, and are thus able to take a more long-term view. It is worth also noting that, as posited by a recent Defra-commissioned report, farming carries a significant emotional as well as economic value. This emotional value is likely to be taken into account by farmers, thus decreasing the rate at which the much anticipated market rationalization process transpires. In sum, it will likely be the case that producers, even the inefficient ones, will only make the decision to leave, or to seriously change their position in, the industry after quite a long period of consideration – and often as a last resort.

One other area of interest is the historic element of agricultural funding under CAP reform. The historic payment is based on the reference period of 2000-02. If farmers think that the base year for historic subsidies calculations will be updated, this could create an incentive to hold onto land and could reduce the extent to which farmers make decisions based on the 'market.' For most farmers and business decision-makers in England the historic reference period affects only a very small part of their payment so this is not of special concern to them. It is however of relevance to farmers in Scotland, Wales and Northern Ireland where the historic payment plays a more significant role in reform policies. More importantly, the SFP is scheduled for review in 2008. At this point, countries that have historic systems in place may be forced to adopt something more like a flat rate payment.

Food Chain Effects

It is hoped that the decoupling of support will encourage farmers to focus more on producing for markets. Some advocates of the SFP argue that reform will strengthen UK farmers' position in the marketplace, enabling them to reduce the "stranglehold" that supermarkets maintain on prices, and allowing them to set food prices that reflect the market more accurately. To date, there has been little evidence to support this shift.

Impact on small farms

Smaller farms are inherently less able to take the long-term view or 'wait-and-see' approach adopted by most of the larger NFU members. Their sensitivity to CAP reform implementation and their tendency toward market rationalization are impacted by several factors. Firstly, the existence of funding schemes complementary to the SFP mitigates small farmers' dependency on SFP monies. Funding for land management under the recently introduced Environmental Stewardship (ES) scheme provides a welcome financial supplement for small farmers. ES provides funding for farmers and other land managers in England who take especially environmentally sound care of their land holdings. The ease with which this funding may be accessed is indicated by recent surveys, which report 94% of English farms expecting to join the ES scheme in the coming year. Although the first round of applications for the ES is not due until August 2005, some 4000 applications have already been received by Defra. The applications for the equivalent agri-environment schemes administered by Scotland and Wales were integrated into the SFP process but complications and deadline extensions make it difficult to estimate the number of farmers involved in the scheme thus far. In fact, a number of small farmers have chosen to forgo the SFP scheme altogether. Whether the calculations behind this choice are based upon histories of negligible subsidy payments, lack of formal accounting practices, an effort to avoid being under Defra's thumb or an aversion to complicated paperwork, the result is a reduced link between small farmers and issues of CAP reform implementation and increased market rationalization within the subsector.

Rural Land Values

To date, the SFP has had no detectable impact on land values in England. In Scotland, Wales and Northern Ireland however, where the historic element plays a more important part in post-reform payments, there has been an uplift in land values.

With regard to agricultural land rental rates, the Tenant Farmers Association (TFA) reports a stagnation in rents over the past two years. The TFA sees the SFP as directly responsible for this trend as both landlords and tenants have been “biding their time” waiting for the SFP scheme to settle in so that they may maneuver the system to their best advantage. This stagnation occurs against a backdrop of a series of reductions in agricultural land rents. As a result of the SFP, these already historically low rents are expected to fall even further in each of the upcoming rent reviews scheduled for the autumn of 2005 and the spring and autumn of 2006.

Conclusion

In conclusion, SFP is still very much in its infancy. After a relatively pain-free introduction, no radical change has been seen. Rather, a steady transition is expected with ongoing rationalization of the sector, albeit now focused on the new support structure, expected to remain a feature of the agricultural sector for many years to come.